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UNCLAS SECTION 01 OF 03 TEGUCIGALPA 000543

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E.O. 12958: N/A

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SUBJECT: High Gas Prices: First Test of Honduran IMF Program

Ref: A) Tegucigalpa 232

B) Tegucigalpa 325

C) 03 Tegucigalpa 2385

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SUMMARY  
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1. (SBU) Summary. A third price hike, in as many months, has brought gasoline and diesel prices in Honduras up to new highs of USD 2.94 and USD 2.02 per gallon, respectively. Gas prices are now 19 percent higher than at the end of 2003 (diesel is up 17.6 percent) and are now clearly the highest in Central America. Taxi, bus, and truck drivers have all been clamoring for relief, and the private sector is urging the legislature to cap prices. Power generators are also trying to obtain an increase in electricity rates, although fuel purchases dedicated to the power sector are exempt from the new 12.5 percent import duty that has been the primary reason for the phased-in price hikes. All of this represents a serious challenge for the GOH as it strives to get off to a good start with the new IMF program and spur economic growth. So far, GOH officials are standing firm. End Summary.

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FUEL PRICES UP ALMOST 20 PERCENT SINCE BEGINNING OF YEAR  
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2. (U) On February 29, 2004, fuel prices in Honduras rose for the third time this year by more than three lempiras (16.7 cents) a gallon (see table below). As of February 29, the price of regular and super gasoline had increased by 19 percent and diesel fuel by 17.6 percent from December 31 of last year. Regular gas increased by 8.5 lempiras to 52.1 lempiras per gallon since the beginning of the year. Diesel fuel increased from 31.9 lempiras to 37.6 lempiras per gallon.

|          | 12/31/03 | 1/2/04 | 2/1/04 | 2/29/04 | Pct Chg |
|----------|----------|--------|--------|---------|---------|
| Super    | 44.75    | 44.46  | 49.98  | 53.22   | 18.90   |
| Regular  | 43.57    | 47.15  | 48.63  | 52.09   | 19.04   |
| Diesel   | 31.94    | 34.82  | 36.38  | 37.56   | 17.56   |
| Kerosene | 27.65    | 31.65  | 31.36  | 31.32   | 13.27   |
| LPG      | 159.94   | 179.25 | 181.33 | 172.82  | 8.05    |

3. (SBU) The GOH, in regulating the market, sets a maximum pump price for oil products, with calculations based on a complex formula first established in the early 1990s. Most retailers use this maximum price as the pump price.

4. (SBU) The key reason for the price hikes has been the new 12.5 percent tariff on fuel products, enacted at the end of 2003 as part of the GOH's efforts to raise government revenues and reach agreement on a three year Poverty Reduction and Growth Facility (PRGF). As noted in ref A, the original executive decree included some unilateral changes to the formula intended to cushion the impact on the consumer by effectively cutting the profit margin allowed to the importers. In the negotiation between the GOH and the oil companies that ensued, this change to the formula (and the reference price) was put on hold for three months, with an agreement that the price increase for consumers would be eased in over a two-month period. At the same time, world oil prices have been rising, putting further pressure on gasoline prices (to the dismay of Honduran officials who had hoped for falling prices to cushion the blow).

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GAS PRICES NOW THE HIGHEST IN THE REGION  
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5. (U) Fuel prices in Honduras thus remain extremely high compared to other countries in the region, with an expected negative impact on competitiveness and the cost of living. The new customs duty is in addition to the flat excise tax on oil products (USD 1.05 per gallon for gasoline). The table below compares prices in Central America in February (i.e. before the latest increase).

Price Per Gallon, February 2004

(in dollars)

|          | Honduras | Salvador | C.R.  | Nicar. | Guatemala |
|----------|----------|----------|-------|--------|-----------|
| Super    | 2.80     | 2.09     | 2.37  | 2.47   | 2.13      |
| Regular  | 2.72     | 2.00     | 2.26  | 2.35   | 2.08      |
| Diesel   | 2.04     | 1.70     | 1.67  | 2.01   | 1.52      |
| Kerosene | 1.76     | --       | 1.68  | 1.94   | 1.67      |
| LPG      | 10.81    | 3.67     | 10.08 | 7.15   | 7.54      |

Source: El Herald, March 2, 2004

16. (SBU) Some Honduran officials believe that there is room to force down the prices charged by oil importers at the border. Some statistics appear to show that pre-tax prices of oil products are much higher for Honduras than neighboring countries. Much of the discussion between the government and the oil companies in the next couple of months will focus on this issue.

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Public Outcry at Latest Hikes  
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17. (U) With the latest gas hike, taxi and bus drivers successfully fought for an increase in the tariffs they are permitted to charge the public. On March 2, the GOH authorized city bus rates to rise from 2.0 to 2.5 lempiras and for the price of a taxi collective ride to rise from 7.5 lempiras to 8.5 lempiras. Regulated intercity bus fares rose by 15 percent as well. Truck drivers agreed to cease a strike and road block near Puerto Cortes on March 4, when the government arranged tri-partite negotiations with the private sector and Congress. These talks are set to start on March 8.

18. (U) The power sector, working through sympathetic legislators, also appears to be trying to obtain an increase in rates they can charge for electricity generation by pushing for increases in regulated electricity tariffs. The general manager of the state-owned electricity company, ENEE, has discounted the proposal as unnecessary at this time, as fuel purchases used in the power sector are exempt from fuel taxes. Members of the private sector also began a campaign to urge the National Congress to set price controls on fuel prices to stop the prices from rising further. Note: The IMF agreement requires the GOH to refrain from any further price control measures. End Note.

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Formation of a Commission to Study the Regulatory Regime  
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19. (SBU) On March 2, prior to leaving for a Central American Presidents summit in Spain, President Maduro announced the establishment of a commission to study possible ways to reduce fuel prices, including a full review of the formula used to set the maximum pump prices. The Commission will be headed by Juan Ferrera, head of the National Convergence Forum, a state entity that attempts to fold the input of civil society into GOH policymaking. Ferrera is a former Finance Minister and former head of the association of oil product distributors. Presidential Advisor, Ramon Medina Luna (a former Minister of Economy), will serve on the Commission and act as the key interlocutor with the GOH on data requests and recommendations. President Maduro also asked former Minister of Industry and Trade, Juliette Handal, to participate in the Commission. Handal has been a key proponent of the change in the reference price used as a proxy for cost in the regulated gas price formula; she has raised serious concern about Medina Luna's participation in the Commission, since she believes that he is largely responsible for the government's policy on fuel prices.

110. (SBU) Ferrera told EconCouns in a March 2 meeting that the Commission plans to complete its work within 60 days. He noted an understanding of the need to maintain budget revenues and to avoid price controls. In recent days, several GOH officials, including Vice Minister of Finance, William Chong Wong, and Ferrera, have indicated privately and publicly the government's resolve to stand fast on the oil tax. Oil company reps have told us that they will urge the government to look for ways to cut tax evasion by informal oil importers and retailers.

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Comment  
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111. (SBU) All of this represents the first test of the new IMF program, approved by the IMF Board on February 18. The GOH knew that the gas tax would be politically controversial, but had hoped that a phase-in of the hikes would give some breathing space and might be accompanied by a decline in world oil prices. Instead, world prices have risen significantly in response to changes in OPEC policy

and developments in other parts of the world, making the decisions in Honduras particularly difficult to defend to a weary public. IMF officials will be watching carefully to ensure that the government continues to meet its fiscal targets and does not violate its commitment to refrain from further price controls. End Comment.

Palmer